JEFFERSON LAKE PETROCHEMICALS OF CANADA LTD.

ANNUAL REPORT 1965

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The next Annual and General Meeting of the Shareholders of the Company will be held at the Royal York Hotel, Toronto, Canada on April 29, 1966 at 11 a.m. A formal notice of the meeting, together with a form of Proxy and Proxy Statement is enclosed with this report.

OFFICES

CALGARY, ALBERTA, CANADA
1000 Calgary House
550 - 6th Avenue S.W.

NEW ORLEANS, LOUISIANA 70130
1408 Whitney Building

PLANTS

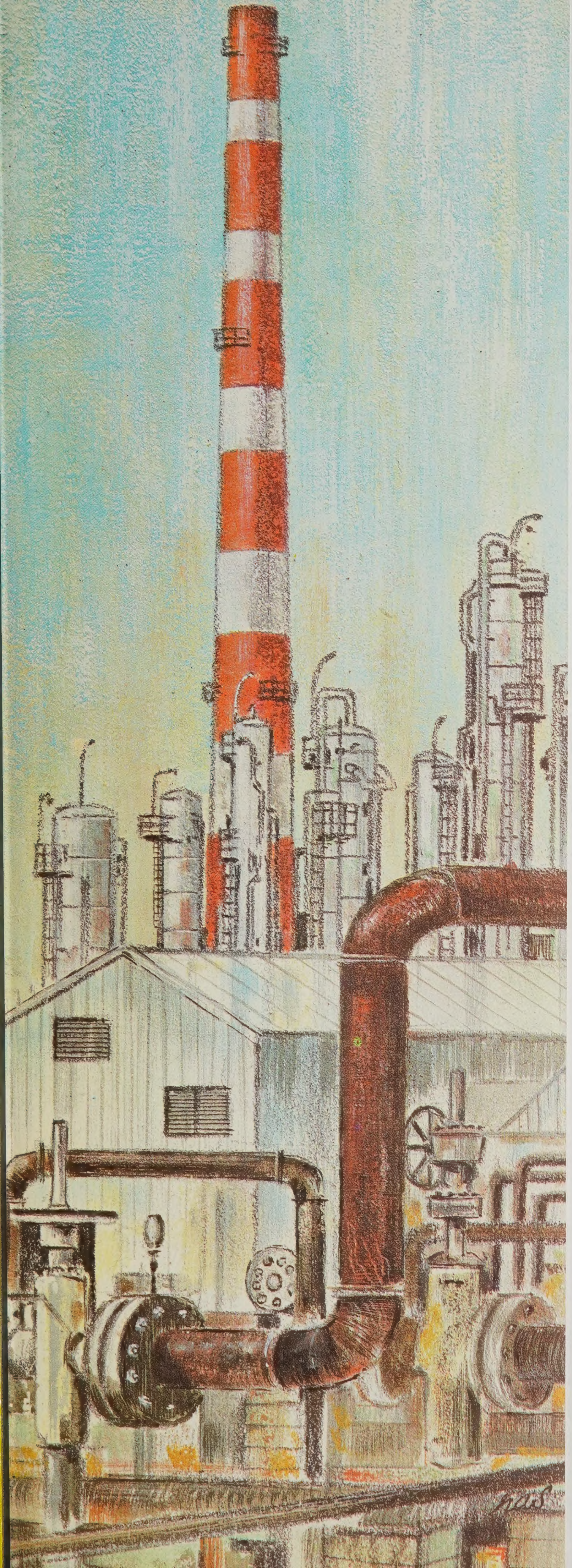
CALGARY PLANT
Balzac, Alberta

Owned by Petrogas Processing Ltd.

Operated by Jefferson Lake Petrochemicals of Canada Ltd.

PEACE RIVER PLANT
Taylor, British Columbia

COLEMAN PLANT
Coleman, Alberta



DIRECTORS

MARSH A. COOPER
Partner, W. F. James, B. S. W. Buffam, and M. A. Cooper, Consulting Geologists, Toronto, Canada

EBERHARD P. DEUTSCH
Senior Partner, Deutsch, Kerrigan & Stiles, Attorneys at Law, New Orleans, Louisiana

ARMAND HAMMER *
President and Chairman of the Board, Occidental Petroleum Corporation, Los Angeles, California

J. HOWARD HAWKE
President of Gairdner & Company Limited, Toronto, Canada

JAMES L. LEWTAS
Partner in Law Firm Campbell, Godfrey & Lewtas, Toronto, Canada

HAROLD W. MANLEY *
President and Managing Director, Calgary, Canada

E. C. REID *
Senior Executive Vice-President, Occidental Petroleum Corporation, Bakersfield, California

ROBERT S. ROSE *
Vice-President and General Counsel, Occidental Petroleum Corporation, Los Angeles, California

CHARLES K. SCHWARTZ
Retired Senior Partner, Gottlieb & Schwartz, Attorneys at Law, Chicago, Illinois

ROBERT A. TEITSWORTH
Vice-President, Occidental Petroleum Corporation, Bakersfield, California

EUGENE H. WALET, JR. *
Chairman of the Board and Chief Executive Officer; President, Jefferson Lake Sulphur Company, Executive Vice-President, Occidental Petroleum Corporation, New Orleans, Louisiana

*Member of the Executive Committee

OFFICERS

EUGENE H. WALET, JR.
Chairman of the Board and Chief Executive Officer

HAROLD W. MANLEY
President and Managing Director

ARMAND HAMMER
Chairman of the Executive Committee

GERALD H. LEWIS, Vice-President

HOWARD B. SHELTON, Vice-President

W. A. TROUGHTON, Vice-President and Secretary

ROBERT A. TEITSWORTH, Vice-President

DONALD J. SHEDDEN, Treasurer

LOUIS E. PARISH, Controller

PAUL C. HEBNER, Assistant Secretary

GENERAL COUNSEL

Deutsch, Kerrigan & Stiles
New Orleans, Louisiana

JEFFERSON LAKE PETROCHEMICALS OF CANADA LTD.

AND WHOLLY-OWNED SUBSIDIARY

ANNUAL REPORT 1965

HIGHLIGHTS OF 1965

Net profits and cash revenues set new records.

Average sales value per long ton of sulphur f.o.b. Plants increased 49% over the previous year.

Of the 667,000 long tons of sulphur exported offshore to 19 countries from all Canadian sources, 29% was shipped from Company operated plants.

Company recoverable pipe line sales gas reserves increased to 343.7 billion cubic feet.

Recoverable reserves of elemental sulphur from sour gas increased by 9.5% since 1964 to 7,924,000 long tons.

102,252 Series "B" Warrants were converted to common stock providing the Company with $747,550.

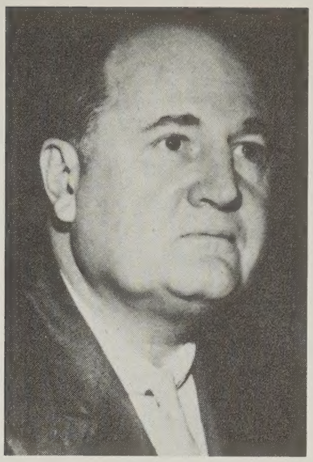
Completed $10,000,000 refinancing at 5½% interest to retire outstanding 6½% Serial "B" Secured Debentures, bank loans, and to increase Company's working capital.

Petrogas Processing Ltd. (31% Company owned) completed L.P.G. facilities and progressed toward second phase expansion which will increase peak pipe line gas sales capacity to 200 million cubic feet and sulphur production to 1,900 long tons per day beginning in 1967.

Company to be Manager-Operator in 1966 of a $6,000,000 joint, equally shared exploration program with Occidental Petroleum Corporation, for the purpose of discovery and development of raw gas and crude oil.

FINANCIAL HIGHLIGHTS

	1965	1964	INCREASE Amount	%
Total Revenue	$ 5,910,102	$ 4,253,179	$ 1,656,923	39
Net Cash Income	2,582,344	1,804,759	777,585	43
Per Share	$ 1.22	$ 0.88	$ 0.34	38
Net Income	2,124,900	1,353,876	771,024	57
Per Share	$ 1.00	$ 0.66	$ 0.34	51
Dividends Paid	634,089	560,791	73,298	13
Per Share	$ 0.30	$ 0.275	$ 0.025	9
Working Capital	9,111,754	2,107,237	7,004,517	332
Retained Earnings	2,691,018	1,200,207	1,490,811	124
Shareholders' Equity	14,261,377	11,956,431	2,304,946	19



Eugene H. Walet, Jr.
CHAIRMAN OF THE BOARD

Harold W. Manley
PRESIDENT

TO THE SHAREHOLDERS AND EMPLOYEES

Jefferson Lake Petrochemicals of Canada Ltd. in 1965 completed its sixth consecutive year of increased earnings, growth and expansion. New records were established in net profits and cash revenues. Production and sales of crude oil, distillates, natural gas liquids and pipe line gas increased, as did sales of elemental sulphur.

EARNINGS AND DIVIDENDS

Net earnings for the year of $2,124,900, equivalent to $1.00 per share on the average number of outstanding shares during the year, represented an increase of 57% over the $1,354,000 and 66¢ per share earned in 1964. Net cash income increased 43% above 1964 to $2,582,000, equal to $1.22 per share. At December 31, 1965, the company had approximately $2,100,000 cumulative drilling and exploration costs deductible for income tax purposes in future years, therefore, no provision for income tax is required. Cash dividends of $634,089 (30¢ per share) as compared to $560,791 in 1964, were paid during the year, an increase of 13%.

RECOVERABLE RESERVES, SALES AND REVENUES

The Company's share of recoverable reserves at December 31, 1965, estimated by independent petroleum engineering firms, were, after deducting 1965 production, greater than at the same date in 1964. The Company's share of pipe line gas reserves increased 9.2% to 343.7 billion cubic feet; recoverable elemental sulphur from sour gas increased 9.5% to 7,924,000 long tons; and crude oil and natural gas liquids increased to 8,597,000 barrels.

Total revenues from all sources were $5,910,000 in 1965, as compared to $4,253,000 in 1964, an increase of 39%. Sulphur sales, f.o.b. plants, increased 64% to $3,353,000; revenues from crude oil, distillates, and natural gas liquids were $657,000, an increase of 11%; and pipe line gas sales were $1,531,000, an increase of 4.7%. The Calgary Petrogas Plant, although operating at capacity, was from time to time, unable to supply peak demands for daily pipe line gas.

FINANCIAL

The Company, in 1965, completed a $10,000,000 5½% (U.S. funds) long term loan from Occidental Petroleum Corporation. Payments on principal will not begin until August, 1970 and will be payable over 15 years. The bank loan of $440,000 and the outstanding Series "B" 6½% Secured Debentures amounting to $4,272,500 were retired. The exercise of Series "B" warrants into the Company's common stock (102,252 shares) provided additional funds of $747,550. These factors, together with retained earnings provided the Company with a strong working capital position, amounting to $9,112,000, at year end, and a ratio of current assets to current liabilities of 8.3 to 1.

OUTLOOK FOR THE COMPANY

World demand for elemental sulphur continued to exceed production in 1965. The price received per long ton f.o.b. the plants substantially increased over the year with the estimated average price for 1966 reflecting price levels approaching those prices received by the sulphur industry 10 years ago.

In October, 1965, Petrogas Processing Ltd. completed at a cost of approximately $3,700,000, its first phase of expansion for the production of liquefied propane and butanes, improved recoveries of distillates, and the removal of excess mercaptan sulphur compounds in the pipe line sales gas. It is anticipated that the second phase expansion of the Plant complex, costing approximately $12,000,000, will be completed by May, 1967. The expanded Plant will have a peak design capacity for producing daily, approximately 200 million cubic feet of pipe line sales gas, 6,200 barrels of natural gas liquids and distillates and 1,900 long tons of elemental sulphur.

This increased production from the Plant expansion will add substantially to the Company's earnings in 1967 and in ensuing years. The Company's share of reserves in the Calgary Gas Field is 26% of pipe line sales gas, 23% of natural gas liquid products and 34% of elemental sulphur. Your Company plans expenditures in excess of $3,000,000 during 1966 for property acquisitions and exploration and development drilling. This will be more than twice the amount expended for similar purposes in 1965. The Company recently concluded final arrangements leading to an agreement with Occidental Petroleum Corporation for the conduct of a joint, equally shared exploratory program amounting to $6,000,000. The primary objective of the program is the discovery and development of sour gas and crude oil reserves in the Western Canadian sedimentary basins. Your Company will be Manager-Operator under the agreement.

The items and operations mentioned above are indicative to some extent of the encouraging prospects which lie immediately ahead.

On behalf of the Directors and Officers of your Company, we express thanks and appreciation to the shareholders for their confidence and support, and to the employees, our gratitude for their continued dedicated efforts which have been a major factor in the Company's success.

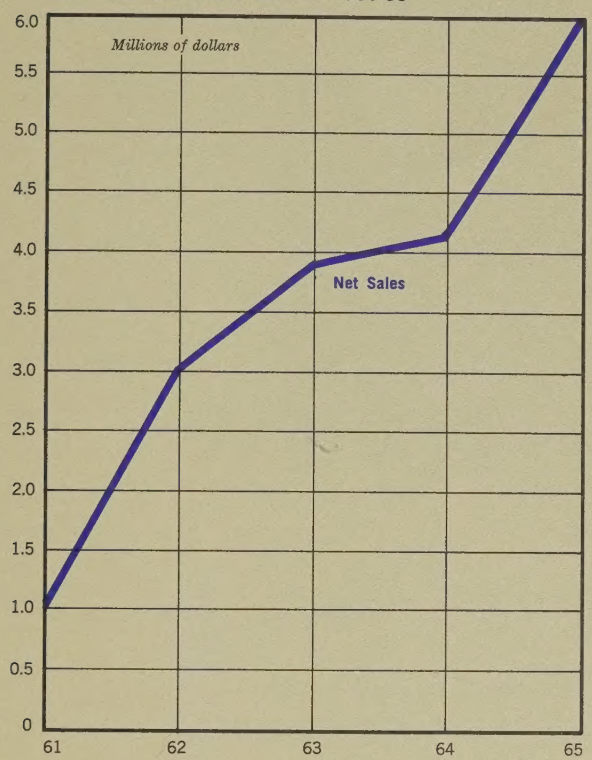
Eugene H. Walet, Jr.
Chairman of the Board

Harold W. Manley
President

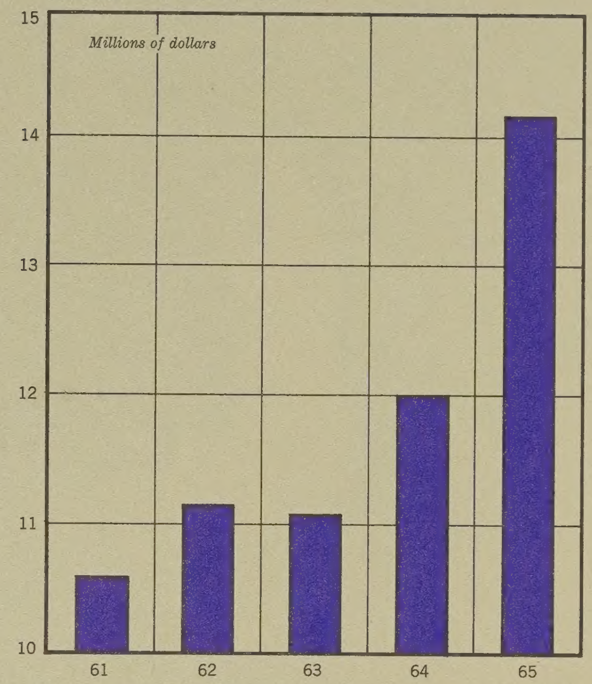
Calgary, Alberta
April 4, 1966

COMPANY GROWTH

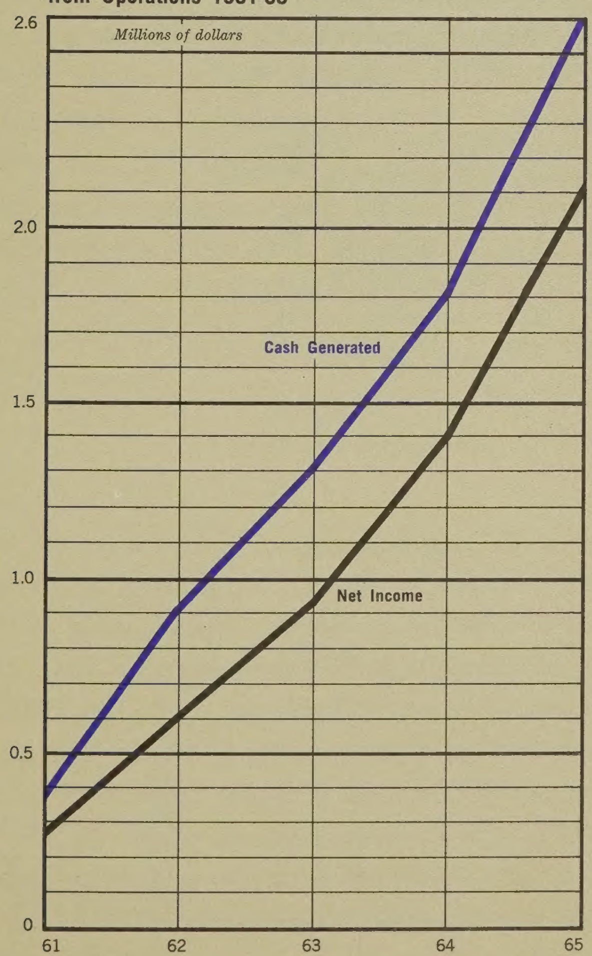
Net Sales and Other Income 1961-65



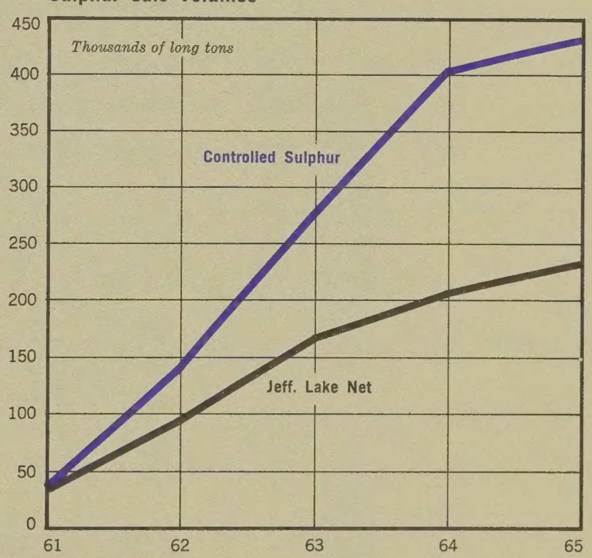
Shareholders Equity 1961-65



Net Income and Cash Generated from Operations 1961-65

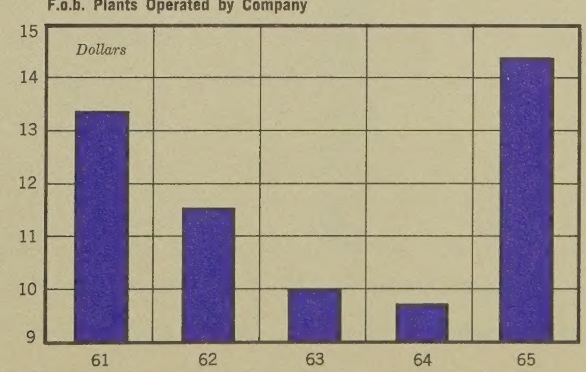


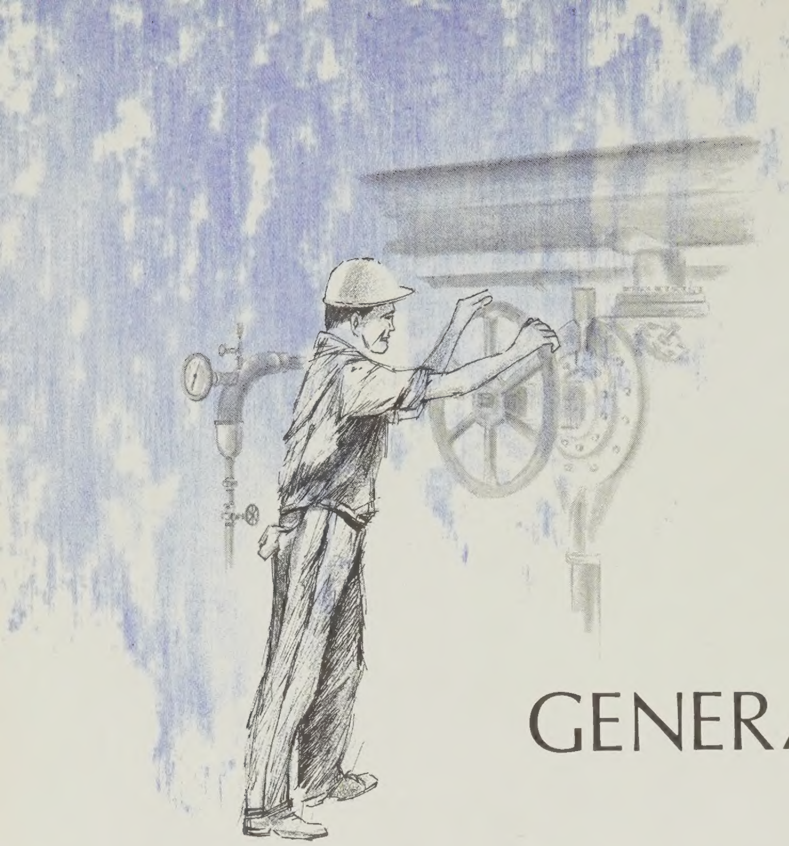
Sulphur Sale Volumes



Average Sulphur Prices 1961-65

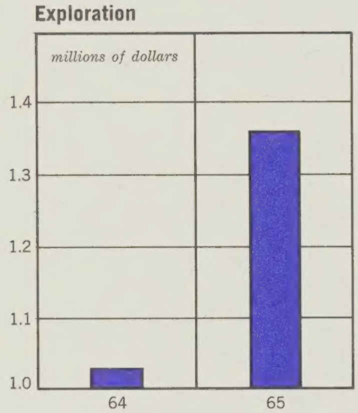
F.o.b. Plants Operated by Company



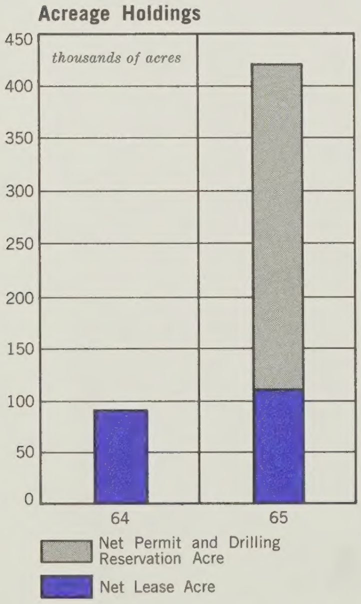


GENERAL REVIEW

Exploration



Acreage Holdings



EXPLORATION

During 1965 the Company emphasized through its exploratory program, the extension of proven sour gas areas in Alberta and the development of crude oil reserves in Saskatchewan at a cost of $1,365,000. Similar costs in 1964 amounted to $1,026,000. In addition, based on detailed geological analysis, the Company has acquired in Alberta, British Columbia and Saskatchewan, substantial acreage spreads in permits and drilling reservations. The Company will be the manager-operator of a joint exploration program in 1966 with Occidental Petroleum Corporation with expenditures of $6,000,000 ($3,000,000 each) directed toward discovery of sour gas and crude oil reserves in the Western Canada sedimentary basin.

ACREAGE HOLDINGS

The Company holds a total of 417,723 acres, 104,196 acres of which were developed and undeveloped leases with 313,527 acres held in Crown permits and drilling reservations. Of the Crown lands, approximately 50% can be converted to lease by future exploration or development operations. While there was no significant change in the Company's developed acreage in 1965, there was nevertheless approximately a 50% increase in the undeveloped acreage in Alberta from 60,896 acres in 1964 to 90,763 acres in 1965. In British Columbia, the Company acquired 239,790 acres of Crown lands of which the Company may retain 50%. In Saskatchewan, the Company's undeveloped acreage increased from 1,368 acres at December 31, 1964 to 52,430 net acres at December 31, 1965.

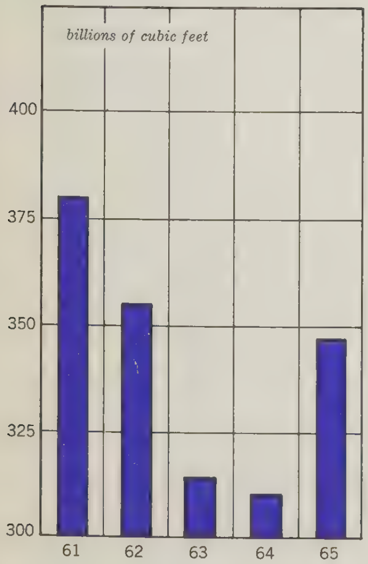
WELLS DRILLED	1965 Gross	1965 Net	1964 Gross	1964 Net
Oil	3	1.2	15	5.7
Gas	8	2.7	3	0.9
Dry	3	1.4	3	1.3
	14	5.3	21	7.9

DRILLING WELLS

Significant increases in recoverable reserves and additional producing capability resulted from the Company's participation in the drilling of fourteen wells, eight of which were development and six of which were exploratory. All of the eight development wells were successfully completed as producing wells having an average depth of 7,509 feet; of these, six were completed for the production of sour gas and the remaining two completed for the production of crude oil. The Company's development completions were equivalent to 2.7 net wells.

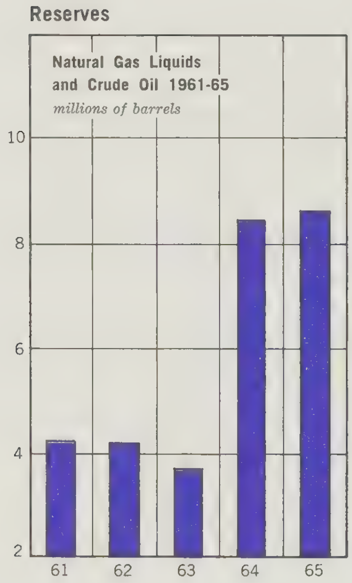
The six exploratory wells were drilled to an average depth of 7,121 feet, and two wells were completed as sour gas producing wells, one well as an oil well, and three as non-commercial wells. The Company's exploratory completions in 1965 resulted in a net of 0.8 of a gas well, a net of 0.5 of an oil well, and 0.3 of a non-commercial well. The sour gas exploration well completions are believed to have extended the East Calgary sour gas field productive trend some eleven miles north of that field's presently unitized producing limits and will require additional drilling in 1966.

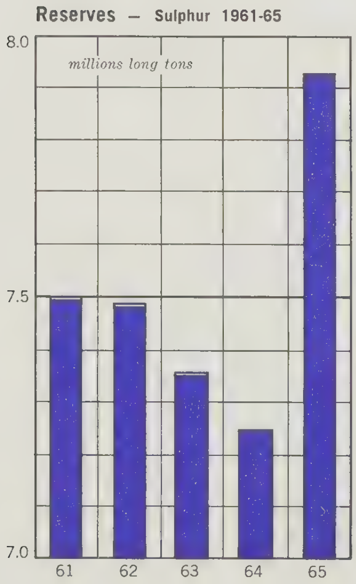
Reserves — Pipeline Gas 1961-65



PRODUCTION

For the fifth consecutive year, increases continued in the production of pipe line sales gas, crude oil, and natural gas liquids including stabilized distillates and the liquefied petroleum gases of propane and butane. Natural gas pipe line sales of the company increased 4.5% over the previous year to a total of 11.3 billion cubic feet, or a daily average of 31 million cubic feet. Crude oil, distillates, and natural gas liquids increased almost 20% over those of 1964 and totalled 265,548 barrels. The East Calgary Petrogas Plant and the Wimborne Field Plant, which was put into operation in May, 1965, were responsible for these increases.





Increased crude oil production was obtained from the Company's leases in the Nottingham and Steelman Fields in Saskatchewan. Sulphur production from the Calgary Petrogas, Coleman, and Wimborne Plants in Alberta, and from the Peace River Plant in British Columbia, totalled 161,330 long tons, a decrease of approximately 13% from the previous year.

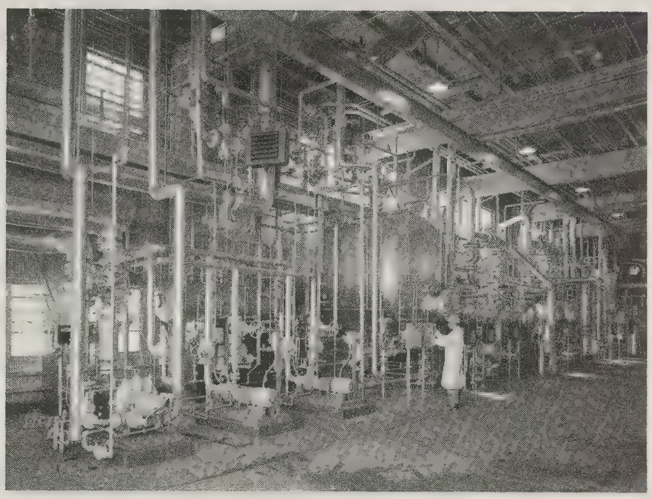
RESERVES

At December 31, 1965, the Company's recoverable reserves, as estimated by independent reservoir petroleum engineering firms, had increased over the same date of 1964 after taking into account the 1965 production.

The Company's share of pipe line gas reserves totalled 343.7 billion cubic feet at the end of 1965, an increase of 31.4 billion cubic feet or 9.2% over the previous year. Principal factors causing the increase in pipe line gas sales reserves were: additional recoverable reserves from the Calgary Crossfield Gas Unit, the exploration of the area in Townships 27 and 28, Ranges 28 and 29, W4M Alberta, of the sour gas reserve extension north of the existing Calgary Crossfield Gas Unit; drilling and development approximately eleven miles north of the Calgary Crossfield Unit, thus proving sour gas reserves which extended the East Crossfield Unit; the Company's share of the Wimborne Field reserves; and the reserves from the Calgary Basal Quartz gas unit now being finalized.

The 1965 year-end recoverable reserves of crude oil and natural gas liquids increased to a total of 8,597,000 barrels.

The Company's interest in proven recoverable elemental sulphur reserves increased 9.5% to 7,924,000 long tons at the year-end of 1965 as compared to its sulphur



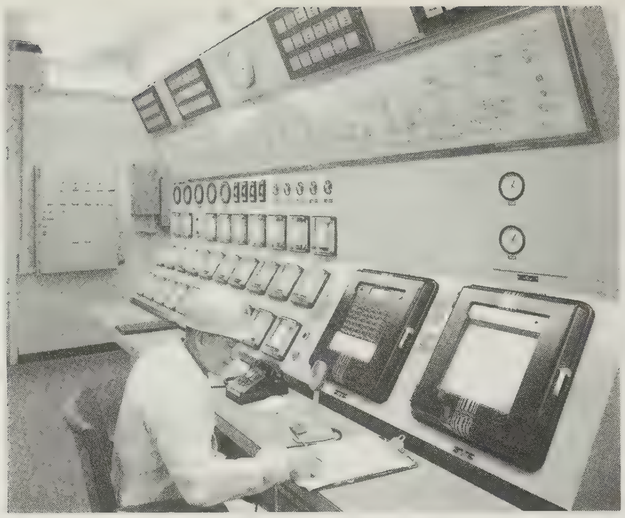
reserves at December 31, 1964. The 685,000 long tons sulphur reserve increase in 1965, after deducting the Company's share of the 1965 sulphur production, was principally the result of extending the productive sour gas trend north of the Calgary Crossfield Gas Unit in Townships 27 and 28, Ranges 28 and 29, W4M, Alberta.

PETROGAS PROCESSING LTD. - CALGARY PLANT EXPANSION

The Company provides the management, supervisory, technical, and operating personnel for the Petrogas Processing Ltd. Calgary Field Plant complex. The Plant processes large quantities of sour gas into finished commercial products. These products include pipe line sales gas, distillates, liquefied gases, and recovered elemental sulphur.

In March, 1965, Petrogas Processing Ltd. completed the sale of $15,000,000 first mortgage bonds, payable in United States funds, with Canadian Chartered Banks and United States Insurance Companies. The funds from this financing will be utilized for the construction of facilities which will practically double the Plant's gas processing capacity and production of finished products. The Company's share of the Calgary Gas Field's reserve, is 35.1% of the Crossfield Gas Unit, 23.2% of the Elkton Gas Unit, and in excess of 38% of the Calgary Basal Quartz Gas Unit now being finalized. As a result, there will be progressive and substantial increased earnings for the Company commencing in 1967 and for many succeeding years.

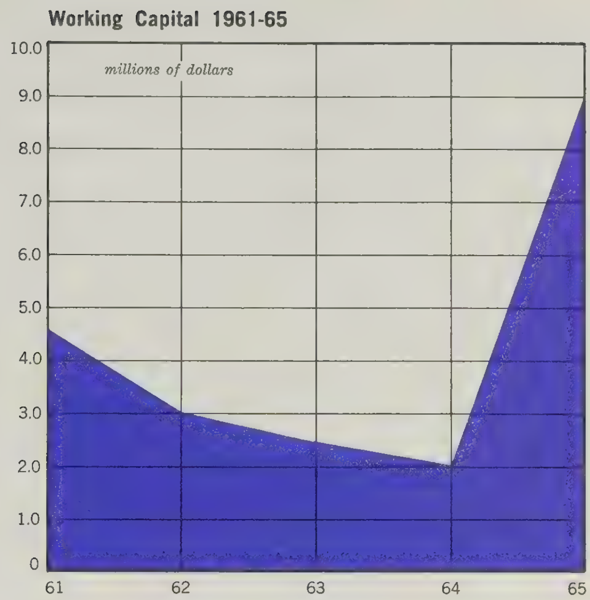
The first phase of the Petrogas Plant expansion for the recovery of liquefied propane and butanes, as well as increased volumes of stabilized distillates and an improved quality of pipe line sales gas, was successfully completed in October,



1965 at a cost of approximately $3,700,000. The major portion of these natural gas liquid products are being sold under the terms of a two year sales contract, to Socony Mobil Oil of Canada Ltd. As a result of the first phase plant expansion, Petrogas is able to meet required mercaptan sulphur specifications necessary for new pipe line gas sales contracts. Petrogas negotiated and executed a pipe line gas sales contract in December, 1965 with Trans-Canada Pipe Lines Ltd. This new gas sales contract, commencing in 1968, requires a peak daily delivery of 40 million cubic feet on a "take or pay" basis. Westcoast Transmission Company has also expanded its peak pipe line gas purchase commitment to the extent that it will be requiring peak daily gas deliveries of 155 million cubic feet starting in 1967.

Process equipment designs and definitive capital cost estimates for the second phase Petrogas Plant complex expansion, costing approximately $12,000,000, are now being completed. Field construction work is expected to start in July, 1966. Subject to deliveries of process equipment and an ample supply of field construction labor, it is anticipated that the second phase Petrogas Plant complex will be completed in May, 1967.

Due to the proven recoverable sour gas reserves having been expanded within the Calgary Field Gas Units and the extensions of the Calgary Crossfield producing zone north of the existing Calgary Crossfield Gas Unit, the final Petrogas Plant design processing capacity will be 125 million cubic feet per day of Elkton and Basal Quartz feed gas, and 160 million cubic feet per day of Crossfield formation feed gas. With this daily maximum gas feed processing capacity of the completed Petrogas Plant expansion, it is expected that the plant complex in 1967 will be capable of a daily production peak of 200 million cubic feet of pipe line sales gas; approximately 6,200 barrels of distillates and natural gas liquids; and, approximately 1,900 long tons of recovered elemental sulphur.



FINANCIAL

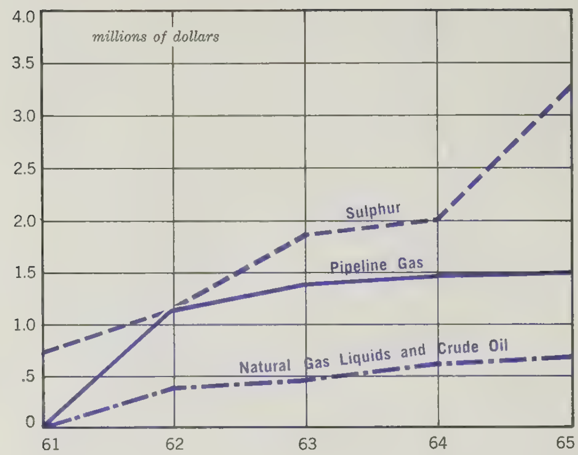
Net earnings and cash generated by the Company and its wholly-owned subsidiary reached record levels during 1965, resulting principally from a 10% increase since 1964 in tonnage of sulphur sold, together with a 49% increase in sulphur sales prices per long ton, f.o.b. Company operated plants. Net profit for 1965 amounted to $2,124,900 equal to $1.00 per share on the average number of outstanding shares during the year. This was 57% higher than in 1964 when profit was $1,354,000 or 66¢ per share.

As explained in Note 9 of the financial statements, the cumulative drilling and exploration costs deductible for income tax purposes have exceeded taxable income. At December 31, 1965, the Company had approximately $2,100,000 available for use in future years, and thus no provision for income taxes was necessary at the year end.

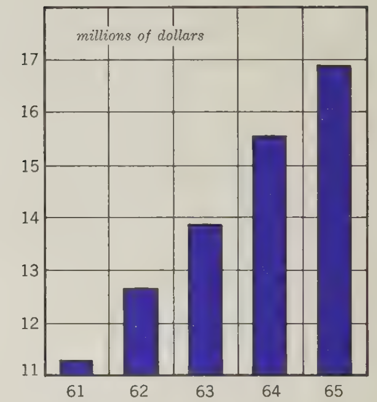
In August, 1965 the Company borrowed $10,000,000 (U.S. funds) at 5½% interest from Occidental Petroleum Corporation. Principal payments begin in August, 1970 and the loan will then be retired over the succeeding 15 years. Bank loans of $440,000 and the outstanding Series "B" 6½% Secured Debentures amounting to $4,272,500 were retired. The Company also received $747,550 on conversion of 102,252 Series "B" Warrants into capital stock. Together with retained earnings, these funds provided the Company with a strong liquid position, with working capital of $9,112,000 and a ratio of current assets to current liabilities of 8.3 to 1.0 at the year end. This resulted after capital expenditures of $1,471,000 and payments of $634,089 in cash dividends during the year. Surplus cash, not required for operations, is invested profitably in short term securities.

Total operating costs and expenses increased by 22% in 1965. This was due principally to higher field operating expense, cost of sour gas purchases and

Net Dollar Product Sales



Gross Capital Assets



royalties, and an increase in technical staff in preparation for the enlarged exploration and development program planned for 1966 and subsequent years. The Company had at the year end a total of 157 employees compared to 128 in January, 1965, an increase of 23%.

The Company's gross dollar sales of products and other income totalled $5,910,000 in 1965 compared to $4,253,000 in 1964, or an increase of approximately 39%. Such gross operating product sales, after deductions for mineral royalty payments, for 1965 as compared to 1964 are as follows:

	1965		1964	
	Total	% of Total	Total	% of Total
Sale of Pipe Line Gas	$1,531,000	27.6	$1,456,000	35.6
Sale of Crude Oil and Condensates . .	$ 641,000	11.6	$ 588,000	14.4
Sale of Liquefied Gases	$ 16,000	0.3	$ —	—
Sale of Sulphur (net f.o.b. Plants) . .	$3,353,000	60.5	$2,044,000	50.0
Total all Products	$5,541,000	100.0	$4,088,000	100.0
Other Income:				
Interest Revenue	$ 152,000		$ 16,000	
Operator's Fees, Sale of Assets and Miscellaneous	$ 217,000		$ 149,000	
Totals	$5,910,000		$4,253,000	

CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

FOR THE YEARS ENDED DECEMBER 31, 1965 AND 1964
(Canadian dollars)

SOURCE OF FUNDS:	1965	1964
Net income and special credit	$ 2,124,900	$ 1,353,876
Add: Depreciation, depletion, amortization and other non-cash items	457,444	450,883
Net cash income	2,582,344	1,804,759
Proceeds of 5½% notes	10,767,419	—
Proceeds of common stock issued on exercise of warrants and employee stock options	814,135	41,827
Bank loan	—	550,000
Other	34,302	46,878
	14,198,200	2,443,464
APPLICATION OF FUNDS:		
Acquisition of fixed assets—		
Leasehold interests	333,425	705,047
Well and exploratory costs	891,225	621,310
Lease and well equipment	139,901	250,259
Sulphur plant equipment	74,441	76,422
Other equipment	32,230	43,590
	1,471,222	1,696,628
Dividends paid	634,089	560,791
Reduction in long-term debt	4,720,377	402,280
Other	367,995	49,777
	7,193,683	2,709,476
Resulting in an increase (decrease) in working capital of	7,004,517	(266,012)
Working capital, beginning of year	2,107,237	2,373,249
Working capital, end of year	$ 9,111,754	$ 2,107,237

CONSOLIDATED

DECEMBER

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ASSETS

	1965	1964
CURRENT ASSETS:		
Cash (Note 2)	$ 6,556,914	$ 263,269
Short-term investments, at cost which approximates market (Note 3)	698,438	200,000
Accounts receivable—		
Trade and other	1,538,509	662,139
Occidental Petroleum Corporation	305,488	—
Petrogas Processing Ltd.	732,492	872,568
Inventories—		
Sulphur, at average production cost which is below market	427,391	809,291
Tubular goods and supplies, at cost	76,258	38,350
Prepaid expenses	20,701	34,877
Total current assets	10,356,191	2,880,494
INVESTMENTS AND OTHER ASSETS, at cost:		
Petrogas Processing Ltd. (Note 4)	463,530	463,530
Pacific Asbestos Corporation formerly Jefferson Lake Asbestos Corporation (Note 5)	807,548	807,548
Less—Provision for loss	(807,548)	(807,548)
Refundable deposits and other investments	32,104	7,213
	495,634	470,743
CAPITAL ASSETS, at cost (Note 1):		
Sulphur extraction plants	3,568,082	3,432,996
Oil and gas properties—		
Leasehold interests and contract rights	7,897,417	7,648,996
Well costs	4,317,776	3,457,709
Well, lease and other equipment	1,030,056	963,479
	16,813,331	15,503,180
Less—Accumulated depreciation	997,874	789,552
Accumulated depletion	992,459	922,067
	1,990,333	1,711,619
	14,822,998	13,791,561
DEFERRED CHARGES (Note 1):		
Debt discount, premium and financing costs, less amortization of $80,285 (1964—$56,004)	522,520	328,903
Other	156,540	57,710
	679,060	386,613
	$26,353,883	$17,529,411

BALANCE SHEET

5 AND 1964

ars)

LIABILITIES AND SHAREHOLDERS' EQUITY

	1965	1964
CURRENT LIABILITIES:		
Accounts payable	$ 806,006	$ 213,850
Accrued interest payable	205,952	50,332
Other accrued liabilities	225,968	106,815
Current portion of long-term liabilities	6,511	402,260
Total current liabilities	1,244,437	773,257
UNREALIZED GAIN ON FOREIGN EXCHANGE	24,909	23,605
LONG-TERM DEBT (less current portion):		
5½% Notes due August 1, 1985 (Note 6)	10,767,419	—
Bank loan at current rate of interest (5¾%) due February 3, 1969	—	440,000
6½% secured sinking-fund debentures due 1981	—	4,272,500
5¼% mortgage repayable in monthly instalments of $909, including interest, to March 1, 1973	55,741	63,618
	10,823,160	4,776,118
SHAREHOLDERS' EQUITY (Notes 7 and 8):		
Capital stock, common shares of a par value of $1 each:		
Authorized—6,000,000 shares		
Outstanding—2,153,210 shares in 1965, 2,041,408 shares in 1964	2,153,210	2,041,408
Capital in excess of par value, per accompanying statement	9,392,733	8,684,822
Series B warrants to purchase shares	24,416	29,994
	11,570,359	10,756,224
Retained earnings, per accompanying statement	2,691,018	1,200,207
	14,261,377	11,956,431
	$26,353,883	$17,529,411

APPROVED ON BEHALF OF THE BOARD:

_______________ Director

G W Manley _______________ Director

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

FOR THE YEARS ENDED DECEMBER 31, 1965 AND 1964
(Canadian dollars)

	1965	1964
Sales and other revenue:		
Gas and oil sales (Note 10)	$ 2,187,779	$ 2,044,384
Sulphur sales, less freight and handling charges	3,353,011	2,044,149
Interest	151,643	15,952
Other income	217,669	148,694
	5,910,102	4,253,179
Costs and expenses:		
Cost of products sold—		
Gas and oil	1,518,992	1,347,919
Sulphur	980,075	709,965
Selling and administrative expenses	806,975	665,030
Interest on long term debt	434,985	327,095
Other expenses	44,175	31,429
	3,785,202	3,081,438
Net income for the year (Note 9)	2,124,900	1,171,741
Special credit:		
Reduction in plant processing charges applicable to prior years	—	182,135
Net income and special credit	2,124,900	1,353,876
Retained earnings, beginning of year	1,200,207	407,122
	3,325,107	1,760,998
Less—		
Cash dividends paid—$.30 per share (1964—$.27½)	634,089	560,791
Retained earnings, end of year	$ 2,691,018	$ 1,200,207

CONSOLIDATED STATEMENT OF CAPITAL IN EXCESS OF PAR VALUE OF CAPITAL STOCK

FOR THE YEARS ENDED DECEMBER 31, 1965 AND 1964
(Canadian dollars)

	1965	1964
Balance, beginning of year	$ 8,684,822	$ 8,650,205
Add:		
Capital in excess of par value arising from exercise of Series B warrants and employee stock options	707,911	34,617
Balance, end of year	$ 9,392,733	$ 8,684,822

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1965

NOTE 1 — ACCOUNTING POLICIES:

The consolidated statements include the accounts of the Company and its wholly owned subsidiary, Jefferson Minerals Corporation, which operates in the United States.

In accounting for oil and gas properties, the Company capitalizes all costs and expenses of acquiring, exploring for and developing oil, gas and sulphur reserves. Provisions for depreciation and depletion of the aggregate unrecovered portion of these costs (including preproduction expenses and costs of non-producing properties) have been computed on the basis of the ratio of the aggregate oil, gas and sulphur production to the aggregate estimated recoverable oil, gas and sulphur reserves.

Depreciation of sulphur plants and related equipment is provided by the unit-of-production method.

Debt discount, premium and financing costs are being amortized by equal annual charges over the life of the 5½% notes.

NOTE 2 — CASH:

At December 31, 1965 cash included $2,975,000 of short-term interest bearing bank deposits and, on January 3 and 4, 1966 the Company invested $3,274,000 in short-term securities.

NOTE 3 — SHORT-TERM INVESTMENTS:

Included in short-term investments is a short-term secured note for $200,000 (past due since August 3, 1965) of Atlantic Acceptance Corporation which was placed in receivership on June 15, 1965. In a preliminary report dated August 18, 1965 the receiver estimated that the secured noteholders would sustain an 8% loss on realization; no provision for such loss has been made in the accounts to December 31, 1965.

NOTE 4 — PETROGAS PROCESSING LTD.:

The Company and certain other working interest mineral owners in the Calgary field incorporated Petrogas Processing Ltd. to construct and own the field facilities and plants for processing field gas from the Calgary field for the recovery of commercial pipeline gas, condensates and sulphur. These facilities and plants are operated by the Company, which has a 30.9% interest in Petrogas Processing Ltd.

NOTE 5 — PACIFIC ASBESTOS CORPORATION (formerly Jefferson Lake Asbestos Corporation):

Due to financial difficulties encountered by Pacific Asbestos Corporation management deemed it prudent to provide in 1963 for a 100% loss on the investment of $807,548 in that company. The Company's counsel have expressed the opinion that the indebtedness of Pacific Asbestos to the Company ranks equally with other unsecured indebtedness, after certain secured bank loans and ahead of certain subordinated indebtedness. Management is unable to determine at this time whether any recovery of the Company's investment will be forthcoming.

NOTE 6 — 5½% NOTES PAYABLE:

The 5½% notes of $10,000,000 (United States dollars) due August 1, 1985 issued to Occidental Petroleum Corporation are subject to required prepayment, without penalty, of 1/20 of the principal amount on August 1, in each of the years 1970 to 1980, inclusive, and .09 of the principal amount on August 1 in each of the years 1981 to 1984, inclusive and to prepayment at the Company's option as specified in the Note agreements.

Under the terms of Note agreements certain limited restrictions are imposed on the Company. Such restrictions had no practical effect at December 31, 1965.

NOTE 7 — WARRANTS:

The Series B warrants, which are not redeemable, entitle the holders to purchase common shares of the Company at prices from $8 per share to June 1, 1966 increasing annually by $1 per share to $13 per share to June 1, 1971, subject to reduction if the Company issues or sells common shares (except by way of stock dividend or option granted to a serving officer or employee of the Company) for a consideration less than the subscription price then in effect under the Series B warrants. During the year ended December 31, 1965, warrants for 102,252 shares were exercised and at that date warrants for an aggregate of 447,597 shares were outstanding.

NOTE 8 — STOCK OPTIONS:

Under the Company's stock option plan a total of 50,000 shares of the Company's authorized and unissued common stock have been reserved for options to be granted to executives and employees of the Company at prices equivalent to the market value on the date of the grant. The options expire five years after the date granted and become exercisable in five equal annual instalments, commencing six months after the date granted. During the year ended December 31, 1965 options on 9,550 shares were exercised at $5.75 to $9.375 per share and at December 31, 1965 options for 21,160 shares were outstanding at prices ranging from $5.75 to $18.80 per share.

Options for an additional 4,500 shares of stock may be granted under the stock option plan.

NOTE 9 — INCOME TAXES:

Under Canadian income tax law, drilling and exploration expenditures may be deducted from income in the year of expenditure or, if such expenditures exceed the income for the year, the excess may be carried forward indefinitely to be applied against the income of future years. No provision for income taxes was required for the period ended December 31, 1965 and at that date an excess of drilling and exploration expenditures of approximately $2,100,000 was available to be carried forward against any future income of the Company for tax purposes.

NOTE 10 — SUPPLEMENTARY INCOME STATEMENT INFORMATION:

Management fees—

Selling and administrative expenses for 1965 include, (a) salaries and other remunerations of $58,036 paid by the Company to directors, (b) management services provided by Jefferson Lake Sulphur Company at a cost to the company of $60,000, (c) a fee of $1 per ton of sulphur sold on behalf of the Company by Jefferson Lake Sulphur Company.

Depreciation, Depletion and Amortization for 1965—

Depreciation relating to sulphur plants in the amount of $83,025 has been charged to production costs of sulphur and selling and administrative expenses.

Depletion of $327,487 and depreciation of $24,568 relating to oil and gas properties has been charged to cost of gas and oil sold.

Amortization of debt discount, premium and financing costs in the amount of $24,281 has been charged to other expenses.

Royalties—

In 1965, royalties have been deducted from gas and oil sales whereas they were treated as a cost of gas and oil sold in prior years; 1964 figures have been restated to conform with this basis.

AUDITORS' REPORT

To the Shareholders of Jefferson Lake Petrochemicals of Canada Ltd.

We have examined the consolidated balance sheet of Jefferson Lake Petrochemicals of Canada Ltd. and its wholly owned subsidiary as at December 31, 1965 and the consolidated statement of income and retained earnings for the year ended on that date. Our examination was made in conformity with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet and consolidated statement of income and retained earnings present fairly the financial position of the companies as at December 31, 1965 and the results of their operations for the year ended on that date, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Our examination also included the accompanying statement of source and application of funds for the year ended December 31, 1965 and, in our opinion, it presents fairly the changes in working capital for the year.

Calgary, Alberta
January 27, 1966

PRICE WATERHOUSE & CO.
Chartered Accountants

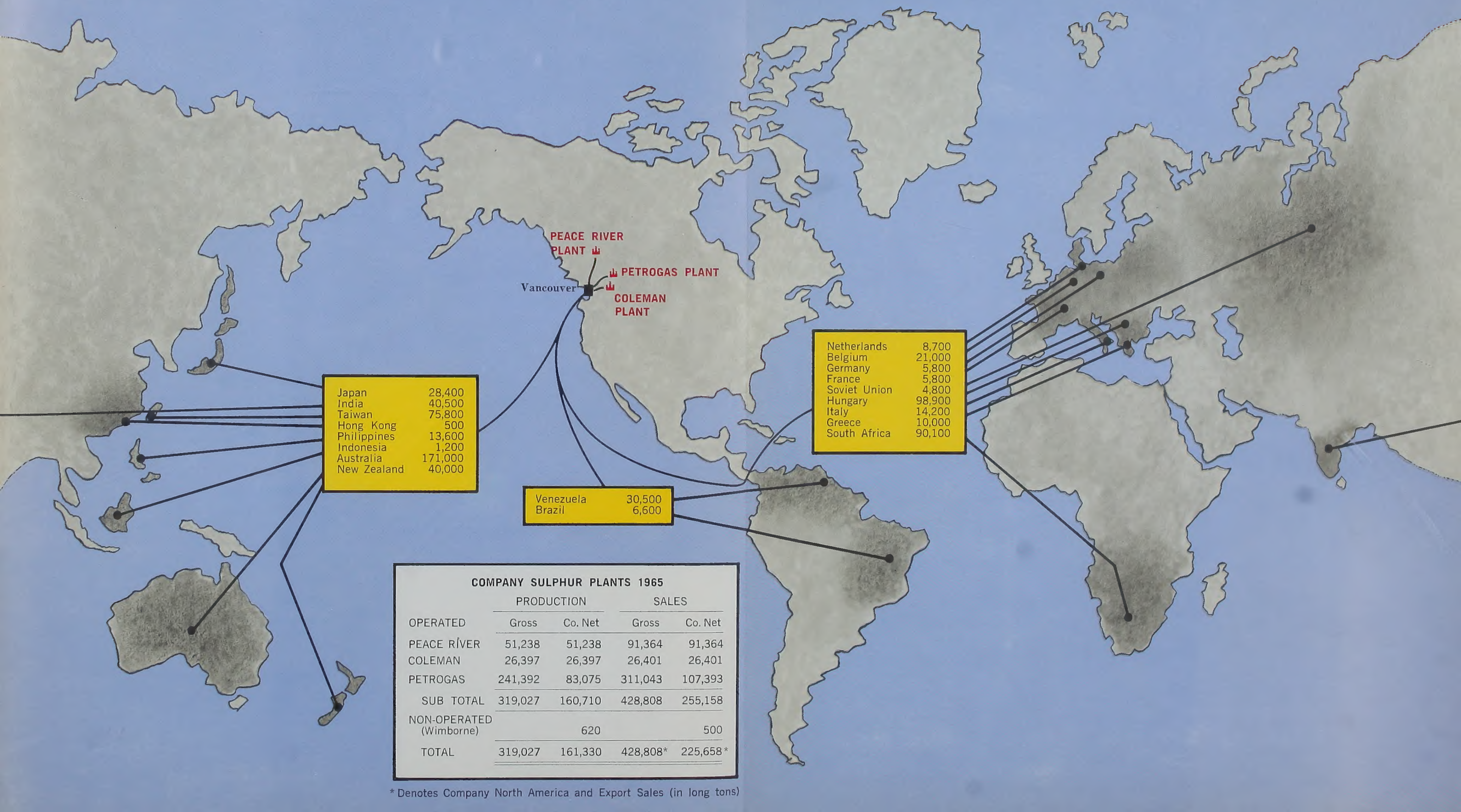
FIVE YEAR FINANCIAL AND OPERATING REVIEW *

		1965	1964	1963	1962	1961
FINANCIAL DATA	Gross Operating Income	$ 5,910	4,253	3,827	2,976	1,044
	Net Income Before Special Credits	$ 2,125	1,172	819	385	284
	Per Share	$ 1.00	.57	.40	.19	.14
	Net Income Including Special Credits	$ 2,125	1,354	933	613	284
	Per Share	$ 1.00	.66	.46	.30	.14
	Dividend Declared Per Share	$ .30	.27½	.12½	—	—
	Working Capital	$ 9,112	2,107	2,373	2,986	4,631
	Long Term Debt (Excluding Current Portion)	$10,823	4,776	4,628	4,943	5,216
	Shareholders' Equity	$14,261	11,956	11,122	11,223	10,613
GROSS PROPERTY ACCOUNTS	Lease Acquisition and Carrying Costs	$ 7,897	7,649	6,967	6,685	6,506
	Wells and Field Equipment	$ 5,061	4,214	3,266	2,488	1,341
	Exploration	$ 110	55	40	23	—
	Plants	$ 3,568	3,433	3,439	3,488	3,315
	Other	$ 177	152	124	51	28
		$16,813	15,503	13,836	12,735	11,190
CAPITAL EXPENDITURES	Lease Acquisition and Carrying Costs	$ 333	705	264	143	127
	Wells and Field Equipment	$ 977	857	852	1,101	67
	Exploration	$ 55	15	18	23	—
	Plants	$ 74	76	5	178	1,347
	Other	$ 32	44	77	26	15
		$ 1,471	1,697	1,216	1,471	1,556
RESERVES	Pipeline Gas (Billions of Cubic Feet)	343.7	312.3	314.5	369.0	377.0
	Natural Gas Liquids and Crude Oil (Thousands Barrels)	8,597.0	8,493.0	3,730.0	4,341.0	4,495.0
	Sulphur (Thousands Long Tons)	7,924	7,239	7,361	7,449	7,505
PRODUCTION	Field Gas (Billions of Cubic Feet)	15.6	15.4	13.2	11.1	0.3
	Pipeline Gas (Billions of Cubic Feet)	11.3	10.8	9.3	8.2	0.3
	Natural Gas Liquids and Crude Oil (Thousands Barrels)	265.5	221.8	177.2	154.2	6.2
	Sulphur (Thousands Long Tons)	161.3	184.9	172.2	149.8	50.4
SALES	Pipeline Gas (Billions of Cubic Feet)	11.3	10.8	9.3	8.2	0.3
	Natural Gas Liquids and Crude Oil (Thousands Barrels)	264.1	221.0	176.2	154.3	0.5
	Sulphur (Thousands Long Tons)	225.7	203.5	168.2	94.0	47.0
WELL DATA	Footage Drilled—Net	35,622	34,146	42,338	57,863	5,267
	Net Wells Capable of Production—Gas	7.6	5.2	5.1	4.8	3.7
	Oil	10.8	10.6	5.0	1.4	—
		18.4	15.8	10.1	6.2	3.7
LEASEHOLDS	Net Acres (Thousands of Acres)	417.7	88.9	74.3	97.1	97.0
EMPLOYEES AND SHAREHOLDERS	Shares Outstanding at December 31	2,153,210	2,041,408	2,034,188	2,029,498	2,028,598
	Shareholders (Number of Shareholders)	3,238	2,454	2,334	2,282	2,358
	Employees (Number of Employees)	157	128	109	109	99

* With the exception of per share figures, dollar amounts are in thousands.

WORLD-WIDE EXPORT OF CANADIAN SULPHUR • 1965 667,400 LONG TONS

FROM JEFFERSON LAKE OPERATED PLANTS 193,665 LONG TONS - 29.0%



COMPANY SULPHUR PLANTS 1965

	PRODUCTION		SALES	
OPERATED	Gross	Co. Net	Gross	Co. Net
PEACE RIVER	51,238	51,238	91,364	91,364
COLEMAN	26,397	26,397	26,401	26,401
PETROGAS	241,392	83,075	311,043	107,393
SUB TOTAL	319,027	160,710	428,808	255,158
NON-OPERATED (Wimborne)		620		500
TOTAL	319,027	161,330	428,808*	225,658*

*Denotes Company North America and Export Sales (in long tons)

TRANSFER AGENTS

National Trust Company, Limited
Toronto, Calgary, Montreal, Winnipeg and Vancouver

The First National City Bank
New York, N.Y.

REGISTRARS

National Trust Company, Limited
Toronto, Calgary, Montreal, Winnipeg and Vancouver

The Chase Manhattan Bank
New York, N.Y.

COUNSEL

McDonald & Considine, Barristers
Calgary, Alberta, Canada

CHARTERED ACCOUNTANTS

Price Waterhouse & Co.
Calgary, Alberta, Canada

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